



Report 09.125
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Committee Council
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Treasury policy – increase in the limits of interest rate swaps

1. Purpose

To enable Greater Wellington to put in place additional interest rate swaps over and above the limits set out in the Treasury Management Policy (TMP).

2. Significance of the decision

This report has been assessed using the Council's Policy on Significance. The matters for decision in this report have been assessed to be of low significance.

Under section 80 of the Local Government Act 2002 if a decision will be significantly inconsistent with plans or policies of the Council, the Council must, when making the decision:

- identify the inconsistency;
- explain why it is proposing to proceed with an inconsistent decision; and
- indicate any intention to amend the plan or policy to accommodate the decision.

Consideration of section 80 follows in this report.

3. Background

In an interest rate swap, each counterparty agrees to pay either a fixed or floating interest rate to the other counterparty. The fixed or floating rate is multiplied by a notional principal amount. This notional amount is generally not exchanged between counterparties, but is used only for calculating the size of cashflows to be exchanged.

Greater Wellington's current TMP has a limit of \$50 million (notional principal) for interest rate swaps that can be undertaken with each registered bank. The notional principal is the amount the interest rate swap is calculated

on. Greater Wellington currently only transacts with four banks giving a total notional principal limit of \$200 million of interest rate swaps that can be entered into.

4. Current situation

Currently, Greater Wellington has \$181 million in notional principal, in respect of interest rate swaps, in place which protects the interest rate risk on a much lower amount of physical debt. The reason for this is that the swaps are for different periods, but under the terms of the TMP they need to be added together. For example, an interest rate swap of \$10 million maturing 1 July 2010 and a new interest rate swap of \$10 million starting on 2 July 2010 counts as \$20 million, even though it is only protecting physical debt of \$10 million.

Furthermore, Greater Wellington has a number of investor swaps in place which have protected our investments against falling interest rates. These have to be included in the \$50 million limit per registered bank.

Therefore, Greater Wellington is greatly restricted in taking out any new interest rate swaps in an environment where debt is increasing and interest rates are at historical lows. The current interest rate environment makes it attractive to enter into additional interest rate swaps. In doing so Greater Wellington will fix its interest cost at relatively lower rates for a number of years.

In addition, as Greater Wellington can only transact up to \$50 million (notional principal) with each registered bank it may force Greater Wellington to transact with a bank not offering the most competitive rate.

5. The recommendation

It is proposed that the Council approves an increase in respect of interest rate swaps, notwithstanding our existing TMP limits. The limit per bank would be increased from \$50 million to \$100 million, however, the total amount of interest rate swaps undertaken would not exceed \$250 million (the current limit is \$200 million).

While the proposed new TMP would allow this increase (as noted in section 6) it does not come into effect until 1 July 2009. Opportunities may be lost if Greater Wellington has to wait until then.

6. Proposed TMP

Greater Wellington's proposed new TMP which will be consulted on as part of the 2009-19 LTCCP uses a different approach to limits. It is based on the term of the swap, as opposed to the face value of the swap based on the following formulae:

Notional principal x maturity (years) x 3%

The current interest swap portfolio has been calculated against the new proposed TMP and the amount is assessed at \$18.5 million for all counter parties. This is well within the limits for the proposed TMP of \$70.0 million.

7. Other matters

Our treasury advisors, Asia Pacific Risk Management, support an increase in limits as outlined in section 5 above. The matter has also been discussed with Simpson Grierson and they have no issues.

8. Recommendations

That the Council:

1. ***Receives*** the report.
2. ***Notes*** the content of the report.
3. ***Notes*** that the recommended increase is inconsistent with the existing TMP, and agrees with the reasons outlined in this report for the proposed increase.
4. ***Notes*** that Greater Wellington is proposing to amend its TMP as part of the 2009-19 LTCCP.
5. ***Approves*** an increase from \$50 million to \$100 million of notional principal on interest rate swaps per registered bank with the aggregate notional principal for all banks not to exceed \$250 million.

Report prepared by:

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